

# **CALIFORNIA LOTTERY**

Audit Report

## **PERSONNEL AND PAYROLL PROCESS**

*July 1, 2009, through June 30, 2011*



**JOHN CHIANG**  
California State Controller

May 2012



**JOHN CHIANG**  
**California State Controller**

May 17, 2012

California Lottery Commission  
700 North Tenth Street  
Sacramento, CA 95811

Dear Commissioners:

The State Controller's Office audited the California Lottery's (Lottery) Personnel and Payroll Process for the period of July 1, 2009, through June 30, 2011.

Our audit disclosed the following deficiencies:

- The Lottery did not properly monitor the personnel and payroll process as it relates to separating employees' transactions. Specifically, the Lottery did not maintain adequate controls for ensuring that accounting and property clearances are made prior to the release of employees' final salary warrants. The Lottery performed the accounting and property clearances after the final salary warrants were issued to employees.
- The Lottery did not properly monitor vacation and annual leave balances to enforce the Department of Personnel Administration's limit on maximum carryover amount of 640 hours. Specifically, the Lottery did not follow up on the "Excess Leave Carryover Memorandums" to ensure that employees had written plans to reduce their excess leave balances, managers submitted the plans to the Personnel Office, and employees reduced their balances according to plans.

The Lottery responded by letter dated April 25, 2012, agreeing with the findings and recommendations.

If you have any questions, please call Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

*Original signed by*

**JEFFREY V. BROWNFIELD**  
Chief, Division of Audits

JVB/vb

cc: Gregory Ahern, Commissioner  
California Lottery Commission  
Nathaniel Kirtman III, Commissioner  
California Lottery Commission  
John Smolin, Commissioner  
California Lottery Commission  
Phil Tagami, Commissioner  
California Lottery Commission  
Robert T. O'Neill, Director  
California Lottery  
Lisa Watson, Deputy Director  
Human Resources Division  
Roberto Zavala, Chief Internal Auditor  
California Lottery

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# Audit Report

## Summary

The State Controller's Office (SCO) audited the California Lottery's (Lottery) personnel and payroll process for the period of July 1, 2009, through June 30, 2011.

Our audit disclosed the following deficiencies:

- The Lottery did not properly monitor the personnel and payroll process as it relates to separating employees' transactions. Specifically, the Lottery did not maintain adequate controls for ensuring that accounting and property clearances are made prior to the release of employees' final salary warrants. The Lottery performed the accounting and property clearances after the final salary warrants were issued to employees.
- The Lottery did not properly monitor vacation and annual leave balances to enforce the Department of Personnel Administration's limit on maximum carryover amount of 640 hours. Specifically, the Lottery did not follow up on the "Excess Leave Carryover Memorandums" to ensure that employees had written plans to reduce their excess leave balances, managers submitted the plans to the Personnel Office, and employees reduced their balances according to plans.

## Background

By authority of the California Constitution, Government Code section 12410 states, "The Controller shall superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provision of law for payment." In addition, Government Code section 12411 stipulates that "...the Controller shall suggest plans for the improvement and management of revenues."

Proposition 37, the California State Lottery Act of 1984 (Lottery Act), amended the California Constitution to authorize the establishment of a statewide lottery, to create the California Lottery Commission, and to give the commission broad powers to oversee the operation of a statewide lottery.

Pursuant to Government Code section 8880.67, the SCO may conduct other special post-audits of the Lottery, as the State Controller deems necessary. The Controller or his/her agents conducting an audit under this chapter shall have access and authority to examine any and all records of the California Lottery Commission.

As of January 1, 2011, the Lottery had approximately 644 employees at different locations, including the headquarters facility, two distribution centers, and nine district offices. The Lottery's Personnel Services Section is responsible for personnel and payroll functions. The Personnel Services Section provides the personnel services mandated by state and federal laws under the direction of state control agencies, including the State Department of Personnel Administration.

## **Objectives, Scope, and Methodology**

The purpose of the audit was to determine whether the Lottery is maintaining effective systems of administrative and internal controls over the personnel and payroll process.

We conducted this performance audit in accordance with generally accepted government auditing standards. We did not audit the Lottery's financial statements. Those standards require that we plan and perform the audit to obtain sufficient appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The specific objectives of the audit were to determine whether the Lottery has controls in place to ensure that:

- Established policies and procedures exist for initiating and processing personnel and payroll transactions
- Adequate separation of duties exists over the personnel and payroll process
- Personnel and payroll transactions are properly approved and certified by authorized personnel only
- Payroll expenditures are recorded correctly, stay within budget, and are allocated to the correct fund and program
- Personnel and payroll records, files, programs, and other data are adequately safeguarded
- State law, policies, and procedures are followed regarding personnel and payroll transactions
- Adequate clearance procedures exist for separating employees

The audit period was July 1, 2009, through June 30, 2011. The scope of the audit included, but was not limited to, the following audit procedures:

- Reviewing the California Lottery Act, Government Code, and any other applicable policies and procedures related to the personnel and payroll audit process
- Reviewing work performed by any external audit organization or by the Lottery Internal Audits Office
- Interviewing and observing individuals involved in the development, authorization, and monitoring of the personnel and payroll process
- Analyzing and evaluating the internal controls for the personnel and payroll process

- Performing tests of procedural compliance to determine whether:
  - Separation of duties exists over the personnel and payroll process
  - Updated authorizations are maintained
  - Leave balances, salary changes, and timesheets are reviewed

## Conclusion

Our audit did not reveal any significant internal control issues or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls over the personnel and payroll process.

However, our audit disclosed the following deficiencies:

- The Lottery did not properly monitor the personnel and payroll process as it relates to separating employees' transactions. Specifically, the Lottery did not maintain adequate controls for ensuring that accounting and property clearances are made prior to the release of employees' final salary warrants. The Lottery performed the accounting and property clearances after the final salary warrants were issued to employees.
- The Lottery did not properly monitoring vacation and annual leave balances to enforce the Department Personnel Administration's limit on maximum carryover amount of 640 hours. Specifically, the Lottery did not follow up on the "Excess Leave Carryover Memorandums" to ensure that employees had written plans to reduce their excess leave balances, managers submitted the plans to the Personnel Office, and employees reduced their balances according to plans.

## Views of Responsible Officials

We issued a draft report to the Lottery dated April 5, 2012. Robert T. O'Neill, Director, responded by letter dated April 25, 2012 (attached). Mr. O'Neill agreed with the findings and recommendations.

## Restricted Use

This report is intended for the information and use of the California Lottery, the California Lottery Commission, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of the final report, which is a matter of public record.

*Original signed by*

JEFFREY V. BROWNFIELD  
Chief, Division of Audits

May 17, 2012

# Findings and Recommendations

**FINDING 1—  
Employee  
separation notices  
not consistently  
monitored**

The Lottery does not maintain adequate controls for ensuring that accounting and property clearances are made prior to the release of employees' final salary warrants. The Lottery uses an "Employee Separation Notice" as a checklist to collect funds or property due back to the State prior to the employee's separation date. We noted that accounting and property clearances are either not being performed or are being performed after the release of the employees' final salary warrants.

We requested 20 notices from the Personnel Services staff. Staff members could not provide 5, or 25%, of the notices. Of the 15 notices provided, 12 were cleared after the release of the employees' final salary warrants. We noted that 17 of the 20 notices, or 85%, of accounting and property clearances were either not performed or were performed after the release of the employees' final salary warrants.

State Administrative Manual section 8580.4, Employee Separations states, in part:

Salary warrants will not be distributed to separating employees until the department has verified that all travel and salary advances have been paid (cleared). It is recommended that a checkout list acknowledging the return of state-owned items such as credit cards, keys, state records, and equipment be completed for separating employees prior to the release of the final warrant.

California Labor Code section 202 requires that wages are due and payable not later than 72 hours after an employee quits his or her employment, unless the employee has given 72 hours previous notice, in which case the employee is entitled to his or her wages at the time of quitting.

If the Lottery does not maintain adequate controls to ensure that "Employee Separation Notices" are completed and accounted for by Personnel Services before the release of employees' final salary warrants, the Lottery risks not collecting funds or property due back to the State.

## Recommendation

The Lottery should maintain controls to ensure that "Employee Separation Notices" are completed and accounted for by Personnel Services before the release of employees' final salary warrants.



Lottery's Response

The Lottery agrees with this finding. The Human Resources Division (HRD) sent a department-wide notification to remind managers and supervisors to complete the required documents for employees who separate from the department. The submission of separation documents will be tracked by HRD and staff will work with the divisions to ensure timely completion. HRD is also working internally with our Information Technology Services Division staff to explore an automated solution to this issue.

SCO's Comment

The Lottery concurs with the finding and recommendation.

**FINDING 2—  
Vacation and  
annual leave  
balances not  
properly  
monitored**

The Lottery did not properly monitor vacation and annual leave balances to enforce the Department of Personnel Administration's limit on maximum carryover amount of 640 hours. On January 1, 2011, in an effort to reduce excess balances and comply with DPA rules, the Lottery's Personnel Office issued "Excess Leave Carryover Memorandums" to department managers. The memorandums (memos) listed employees who had a leave balance that exceeded the 640 hours, and required the employees to submit a written plan outlining how they would reduce the excess leave balance. The department manager was to approve the plan and submit it to the Personnel Office by January 31, 2011. However, we noted that the Lottery did not follow up on the memos to ensure that employees had written plans to reduce their excess leave balances, managers submitted the plans to the Personnel Office, and employees reduced their balances according to the plans.

Based on the Leave Activity and Balance Report dated August 17, 2011, we noted that:

- 21 of 25 (84%) employees' leave balances that exceeded the DPA rules increased rather than decreased during the period of January 1, 2011, to July 19, 2011.
- 3 of 5 (60%) employees tested did not have evidence of written plans to reduce their excess leave balances.

Title 2, *California Code of Regulations*, Administration, sections 599.752 and 599.738, state that an employee should not accumulate more than 80 days (640 hours) of vacation or annual leave.

The Lottery did not follow-up on the memos to ensure that employees had written plans to reduce their excess leave balances, managers submitted the plans to the Personnel Office, and employees reduced balances according to the plans. As a result, the Lottery does not comply with the Title 2, *California Code of Regulations*, Administration, sections 599.752 and 599.738, which state that an employee should not accumulate more than 640 hours of vacation or annual leave.

Recommendation

The Lottery should follow up on the “Excess Leave Carryover Memorandums” to ensure that:

- Employees’ leave carryover balances do not exceed the DPA’s limit on maximum carryover amount of 640 hours.
- Employees have written plans to reduce excess leave balances.
- Management submits the written plans to the Personnel Office by the stated date.
- Employees reduce excess leave hours according to plans.

Lottery’s Response

The Lottery agrees with this finding. The HRD initiated an annual process in February 2012 to address this issue. HRD sent a notification to all divisions requesting completion of the plans. HRD will also follow-up with the divisions as necessary to track submission of the excess leave usage plans and remind managers to ensure their staff are using excess leave according to tier plans.

SCO’s Comment

The Lottery concurs with the finding and recommendation.

**Attachment—  
California Lottery's  
Response to Draft Report**

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April 25, 2012

Jeffrey V. Brownfield, Chief  
Division of Audits  
State Controller's Office  
P.O. Box 942850  
Sacramento, CA 94250-5874

Re: Lottery Personnel and Payroll Process Draft Audit Report

Dear Mr. Brownfield:

The California Lottery (Lottery) offers the following comments regarding the recently concluded audit of the Lottery's Personnel and Payroll Process conducted by the State Controller's Office (SCO). As stated in the draft audit report dated April 5, 2012, the specific objectives of the audit (for the period for the period July 1, 2009 through June 30, 2011) were to determine whether the Lottery has controls in place to ensure that:

- Established policies and procedures exist for initiating and processing personnel and payroll transactions;
- Adequate separation of duties exists over personnel and payroll process;
- Personnel and payroll transactions are properly approved and certified by authorized personnel only;
- Payroll expenditures are recorded correctly, stay within budget, and are allocated to the correct fund and program;
- Personnel and payroll records, files, programs, and other data are adequately safeguarded;
- State law, policies and procedures are followed regarding personnel and payroll transactions; and
- Adequate clearance procedures exist for separating employees.

We are pleased with the results of the audit and thank you for the opportunity to respond to the draft audit report. Although no significant internal control issues were identified, the audit identified opportunities to improve the timely completion of employee separation notices and the monitoring of vacation and annual leave balances. The Human Resources Division has implemented changes to address these issues.

In summary, we found value in the results of the audit. Presented below are specific responses to each of the audit findings:

**Finding 1**

The Lottery did not properly monitor the personnel and payroll process as it relates to separating employees' transactions. Specifically, the Lottery did not maintain adequate controls for ensuring that accounting and property clearances were made prior to the release of the employees' final salary warrants. It performed the accounting and property clearances after the final warrants were issued to employees.

**Recommendation**

The Lottery should maintain controls to ensure that "Employee Separation Notices" are completed and accounted for by Personnel Services before the release of employees' final salary warrants.

**Response**

The Lottery agrees with this finding. The Human Resources Division (HRD) sent a department-wide notification to remind managers and supervisors to complete the required documents for employees who separate from the department. The submission of separation documents will be tracked by HRD and staff will work with the divisions to ensure timely completion. HRD is also working internally with our Information Technology Services Division staff to explore an automated solution to this issue.

**Finding 2**

The Lottery did not properly monitor vacation and annual leave balances to enforce the Department of Personnel (DPA) maximum carryover amount of 640 hours. Specifically, the Lottery did not follow up on the "Excess Leave Carryover Memorandums" to ensure that employees had written plans to reduce their excess leave balances, managers submitted the plans to the Personnel Office, and employees reduced their balances according to the plans.

**Recommendation**

The Lottery should follow up on the "Excess Leave Carryover Memorandums" to ensure that:

- Employees' leave carryover balances do not exceed the DPA maximum carryover limit of 640 hours.
- Employees have written plans to reduce excess leave balances.
- Management submits the written plans to the Personnel Office by the stated date.
- Employees reduce excess leave hours according to plans.

Jeffrey V. Brownfield  
April 25, 2012  
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**Response**

The Lottery agrees with this finding. The HRD initiated an annual process in February 2012 to address this issue. HRD sent a notification to all divisions requesting completion of the plans. HRD will also follow-up with the divisions as necessary to track submission of the excess leave usage plans and remind managers to ensure their staff are using excess leave according to their plans.

If you have any additional questions, please contact my Audit Chief, Roberto Zavala at (916) 822-8358.

Sincerely,

A handwritten signature in blue ink, appearing to read "R.T. O'Neill", is written above the printed name.

Robert T. O'Neill  
Director

**State Controller's Office  
Division of Audits  
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